# TCM INSIGHTS

## MARKET CONDITIONS: PERSPECTIVE & OUTLOOK

There has been no shortage of explanations for why the market sold off so quickly in the last several months of 2018, as well as for the rapid recovery earlier this year. The likely culprit was a "priced in" recession, or major slowdown in the U.S. economy, which now seems to have been overestimated. Another contributing factor was the lack of value-biased investors that typically buy on such pullbacks. With the growing amount of passive, index-based investors, structural changes in capital markets may have contributed to the severity of the sell off. Recent data reveals that passive investors make up 45% of the capital invested in domestic equity funds, compared to 25% just a decade ago. In that time, this trend has proven its ability to generate price inefficiencies, which in turn creates new buying opportunities for our active managers. The remainder of the calendar year will be a window for our managers to take advantage of these opportunities, specifically in the home building, consumer discretionary, technology, and health care arenas.

Market conditions can sometimes be frustrating for fundamentals-based investors, but such discipline should never be abandoned. Fundamental investment strategies are designed to identify quality companies that possess strong management teams, profitable business models, and reasonable stock prices. These strategies do not attempt to time interest rates, currency valuations, commodity prices, or the markets. Instead, it involves gathering and analyzing measurable and meaningful data. Currently such data reveals the following conclusions: 1) most executive management teams appear cautiously optimistic regarding demand growth, pricing power, earnings, and margin improvements over the next twelve months, 2) balance sheets are carrying more debt than several years ago, but still seem manageable, and 3) the typical warning signs of a recession are not presenting themselves yet.

**The Rest of 2019**

The remainder of the year will undoubtedly present several new challenges and the recent return of volatility is not surprising. The good news is that increased volatility always presents bargains for active managers who employ fundamentally-driven investment strategies. Macroeconomic analysis can feel overwhelming at times, but over the long-term stock performance is driven primarily by future earnings and cash flows of individual businesses.

However, several indicators of a late-stage expansion phase within an economic cycle are clear. Inflationary and labor cost pressures for certain industries is again present. The numbers also suggest that P/E multiples for U.S. stocks will not experience meaningful expansion in the foreseeable future. Finally, any further market gains would most likely be supported by modest earnings and stable multiples for most of the economically sensitive sectors of the market.

Trent Capital Management

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